

Equities

10 January 2011 | 7 pages

Patni Computer Systems (PTNI.BO)

Sell: Contours of the iGate Deal

- Deal with iGate announced** — Patni today announced that the three Patni brothers holding ~45.6% and General Atlantic (GA) holding ~17.4% (including ADRs) have reached an agreement to sell their stake to iGate Corp. for a consideration of Rs503.5 per share (deal size: ~\$921m). There is no provision for any non-compete fees and the deal is expected to close by 1HCY11. The deal values Patni at ~14x CY11E EPS.
- Open offer triggered** — According to SEBI rules, iGate will have to make an open offer for an additional 20% stake in Patni at the same price. If the open offer is successful, then iGate will end up holding ~83%. The acceptance ratio will depend on the number of shares tendered which in turn is likely to be driven by the timing/price of purchase and taxation (open offer is an off-market transaction).
- Creation of a ~\$1bn entity** — We expect Patni to clock ~\$700m of revs in CY10 while the consensus expectations for iGate is ~\$280m. Thus the merged entity will be ~\$1bn in revenues, which should enable it to participate in larger deals going forward. iGate expects the transaction to be cash accretive only by 2012.
- Details of funding (for iGate)** — At the end of 3QCY10, iGate had ~\$125m of cash while Patni had ~\$320m. iGate proposes to raise \$700m of debt from Royal Bank of Canada (also a client) and Jeffries and Co. It also has a revolving line of credit of \$50m. Additionally it plans to issue equity to the tune of \$270-480m (depending on the success of the open offer) to Apex Partners (its consortium partner). The interest burden will be significant given the size of the P&L.
- Maintain Sell** — The deal has been rumored for a while - the final price is below what was expected (in the press). Integration is always a challenge - the synergies will take time to play out. In the interim, we believe that, with the management focus on the integration, growth could continue to be a challenge. Delisting from Indian exchanges (and expectations of a premium for the same) could be a medium-term catalyst – and is a risk to our negative view.

Company Update

Sell/Medium Risk	3M
Price (10 Jan 11)	Rs463.85
Target price	Rs465.00
Expected share price return	0.2%
Expected dividend yield	0.9%
Expected total return	1.1%
Market Cap	Rs60,945M US\$1,344M

Price Performance (RIC: PTNI.BO, BB: PATNI IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	4,433	34.49	4.2	13.4	2.1	16.2	0.6
2009A	5,720	43.10	25.0	10.8	1.7	18.3	0.6
2010E	5,451	40.72	-5.5	11.4	2.0	16.9	1.4
2011E	4,738	35.40	-13.1	13.1	1.8	14.9	1.1
2012E	5,018	37.48	5.9	12.4	1.6	14.0	1.3

Source: Powered by dataCentral

Surendra Goyal, CFA

 +91-22-6631-9870
 surendra.goyal@citi.com

Vishal Agarwal

 +91-22-6616-2742
 vishal1.agarwal@citi.com

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Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	13.4	10.8	11.4	13.1	12.4
EV/EBITDA adjusted (x)	8.9	6.7	7.0	7.0	6.1
P/BV (x)	2.1	1.7	2.0	1.8	1.6
Dividend yield (%)	0.6	0.6	14.4	1.1	1.3
Per Share Data (Rs)					
EPS adjusted	34.49	43.10	40.72	35.40	37.48
EPS reported	34.49	43.10	40.72	35.40	37.48
BVPS	215.98	269.45	228.64	259.12	290.58
DPS	3.00	3.00	67.00	5.00	6.00
Profit & Loss (RsM)					
Net sales	31,825	31,620	31,683	35,638	40,425
Operating expenses	-27,665	-26,317	-26,579	-30,243	-34,649
EBIT	4,160	5,303	5,104	5,395	5,776
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	484	657	1,499	821	936
Pre-tax profit	4,645	5,960	6,603	6,216	6,713
Tax	-211	-240	-1,152	-1,478	-1,695
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	4,433	5,720	5,451	4,738	5,018
Adjusted earnings	4,433	5,720	5,451	4,738	5,018
Adjusted EBITDA	5,261	6,474	6,250	6,575	7,131
Growth Rates (%)					
Sales	18.1	-0.6	0.2	12.5	13.4
EBIT adjusted	6.7	27.5	-3.7	5.7	7.1
EBITDA adjusted	8.1	23.1	-3.5	5.2	8.5
EPS adjusted	4.2	25.0	-5.5	-13.1	5.9
Cash Flow (RsM)					
Operating cash flow	6,783	4,263	4,471	4,622	4,861
Depreciation/amortization	1,100	1,171	1,145	1,179	1,354
Net working capital	2,578	-1,484	-1,324	-475	-574
Investing cash flow	-1,517	169	-444	-1,593	-1,915
Capital expenditure	-1,692	-689	-632	-2,116	-2,682
Acquisitions/disposals	-602	371	-491	0	0
Financing cash flow	-3,537	1,200	-10,295	-763	-916
Borrowings	-4	-5	-3	0	0
Dividends paid	-451	-452	-10,224	-763	-916
Change in cash	1,730	5,633	-6,269	2,266	2,030
Balance Sheet (RsM)					
Total assets	36,572	41,815	37,268	41,638	46,793
Cash & cash equivalent	14,751	20,384	14,115	16,381	18,412
Accounts receivable	0	0	0	0	0
Net fixed assets	7,332	6,850	6,337	7,273	8,601
Total liabilities	8,834	7,152	7,447	7,842	8,895
Accounts payable	0	0	0	0	0
Total Debt	9	4	2	2	2
Shareholders' funds	27,737	34,662	29,821	33,796	37,898
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	16.5	20.5	19.7	18.4	17.6
ROE adjusted	16.2	18.3	16.9	14.9	14.0
ROIC adjusted	25.8	32.5	23.0	20.6	19.3
Net debt to equity	-53.1	-58.8	-47.3	-48.5	-48.6
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Patni Computer Systems

Valuation

Our target price of Rs465 is based on 13x Mar'12E EPS. This is closer to the higher end of the ~2-16x band that the stock has traded in over the past three-years and is higher than the average of ~8x. We believe that this is justified given that revenue visibility is improving (across the sector) and Patni has made some good effort in cost cutting. We believe PE is the most appropriate valuation measure to value the stock given Patni's track record in profitability.

Risks

We rate Patni shares Medium Risk in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key upside risks that could cause the shares to exceed our target price include: (1) uptick in growth rates; (2) any significant depreciation of the rupee against the USD/EUR/GBP; (3) sharp recovery in the US economy; and (4) any value-generating acquisition.

Appendix A-1

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Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA

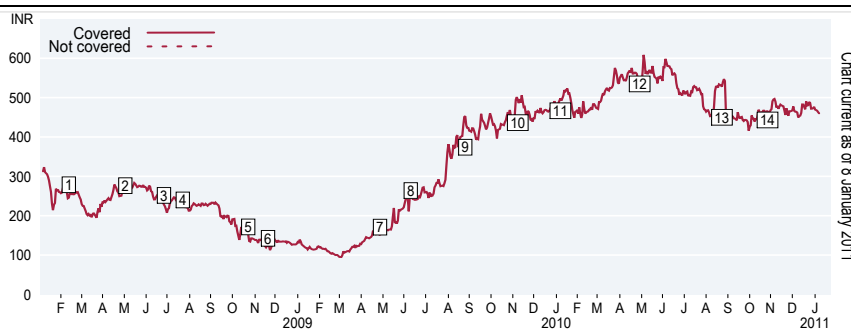


Chart current as of 8 January 2011

	Date	Rating	Target Price	Closing Price
1	13-Feb-08	1H	*390.00	245.70
2	2-May-08	1H	*365.00	270.90
3	26-Jun-08	1H	*340.00	228.05
4	23-Jul-08	*3H	*260.00	235.80
5	23-Oct-08	3H	*140.00	152.25

* Indicates change

	Date	Rating	Target Price	Closing Price
6	20-Nov-08	3H	*125.00	123.60
7	28-Apr-09	3H	*150.00	150.40
8	10-Jun-09	3H	*240.00	259.90
9	26-Aug-09	*3M	*440.00	452.95
10	9-Nov-09	3M	*470.00	494.55

	Date	Rating	Target Price	Closing Price
11	7-Jan-10	3M	*525.00	498.20
12	29-Apr-10	3M	*545.00	534.80
13	24-Aug-10	3M	*520.00	527.90
14	27-Oct-10	3M	*465.00	465.30

Rating/target price changes above reflect Eastern Standard Time

Patni Computer Systems (PTNI.BO)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Surendra Goyal, CFA

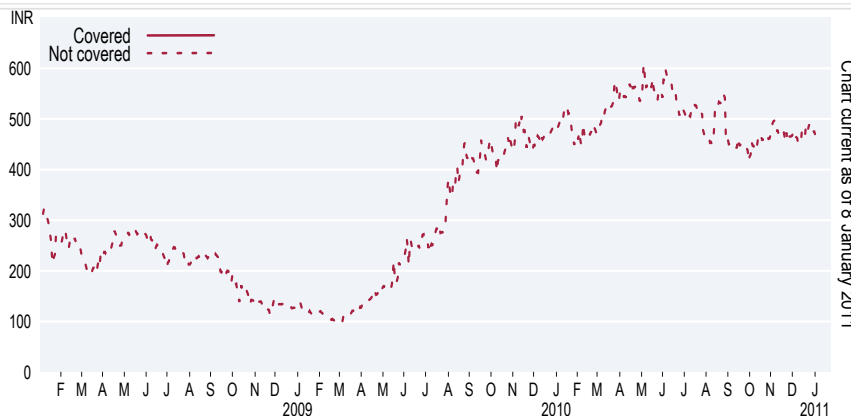


Chart current as of 8 January 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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